

Office of Chief Counsel
Internal Revenue Service
memorandum

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RTBennett

date: 10/31/01

to: John Deamus, Senior Team Coordinator
Michael Taynor, Senior Team Coordinator

from: William F. Halley, Associate Area Counsel, LMSB, Newark

subject: [REDACTED] Specified liability loss and
mitigation.
Tax Years: [REDACTED], [REDACTED]
UIL: 1312.03-00

This memorandum responds to your request for assistance dated September 27, 2001. This memorandum should not be cited as precedent.

Facts.

The taxpayer had a net operating loss for tax year [REDACTED]. The entire NOL was carried back three years to tax year [REDACTED]. This resulted in a \$ [REDACTED] decrease of tax for tax year [REDACTED]. The taxpayer's return for tax year [REDACTED] was audited. As a result of the audit, the NOL carryback was reduced. The tax for tax year [REDACTED] was increased by \$ [REDACTED]. This tax was assessed in [REDACTED]. The taxpayer paid the \$ [REDACTED] tax, and interest, in [REDACTED]. The statute of limitations for assessment of the [REDACTED] tax year had been extended to [REDACTED].

In [REDACTED], the taxpayer filed an amended return Form 1120X asserting that a portion of the agreed NOL from tax year [REDACTED] qualified for a ten year carryback under section 172(f) of the Internal Revenue Code.¹ The taxpayer, however, did not make any adjustment to the NOL which it had previously carried back and claimed in tax year [REDACTED]. The audit team agrees that a portion of the loss on the Form 1120X qualifies for a ten year carryback under section 172(f). The taxpayer carried back this

¹Unless otherwise indicated, all section references denote the Internal Revenue Code of 1986 as in effect for the years in issue.

portion in its entirety to tax year [REDACTED].

The audit team questions whether it can currently make any adjustment with respect to the [REDACTED] tax year in the event that it allows the claim in [REDACTED].

Issue.

Whether the Service may adjust the taxpayer's income in tax year [REDACTED], despite that the statute of limitations on assessment for tax year [REDACTED] was open for a period of time following the filing of the taxpayer's claim for refund for tax year [REDACTED] but has since expired?

Conclusion.

The Service may adjust the taxpayer's income in tax year [REDACTED] under the mitigation provisions of the Internal Revenue Code.

Discussion.

Generally, the Service must assess the amount of tax imposed within three years after the return was filed. Section 6501(a). The Service and the taxpayer may agree to extend the time to assess. Section 6501(c)(4). In the instant case, the Service and the taxpayer agreed to extend the time to assess tax for tax year [REDACTED] until [REDACTED]. A deficiency attributable to an NOL carryback "may be assessed at any time before the expiration of the period within which a deficiency for the taxable year of the net operating loss...which results in such carryback may be assessed." Section 6501(h).

In our case, the taxpayer initially carried back the NOL from tax year [REDACTED] to tax year [REDACTED]. Therefore, the Service could have assessed a deficiency for tax year [REDACTED] until June 30, [REDACTED] under sections 6501(c)(4) and (h). The Service did not make any assessment with respect to tax year [REDACTED] after the taxpayer filed its claim for refund in [REDACTED]. Section 6501 would currently bar the Service from assessing any additional tax for tax year [REDACTED]. The mitigation provisions of the Code, sections 1311 through 1314, however, provide a remedy for the Service in this situation which allows it to make an adjustment to the taxpayer's income tax in tax year [REDACTED].

Section 1311(a) states, in pertinent part,

"If a determination...is described in one or more paragraphs of section 1312 and, on the date of the

determination, correction of the effect of the error referred to in the applicable paragraph of section 1312 is prevented by the operation of any law...then the effect of the error shall be corrected by adjustment..."

An expiration of the period of limitations for assessment under section 6501 is an example of such a "law." Treas. Reg. §1.1311(a)-2(a). An adjustment authorized under section 1311 exists if the "determination allows a deduction or credit which was erroneously allowed to the taxpayer for another taxable year..." Section 1312(2). A "determination" includes a "final disposition by the Secretary of a claim for refund." Section 1313(a)(3). A claim for refund is "deemed finally disposed of by the Secretary on the date the refund or credit is allowed." Section 1313(a)(3)(A). If an additional assessment results from the correction, the taxpayer must be maintaining an inconsistent position with the erroneous treatment of the item in the closed year. Treas. Reg. §1.1311(a)-1(b).

In our case, absent the mitigation provisions, the Service currently would be barred from assessing the taxpayer's income tax liability for tax year [REDACTED]. The statute of limitations for assessing the tax liability for tax year [REDACTED] expired [REDACTED]. See section 6501(h). The taxpayer has filed a claim for refund for tax year [REDACTED] in which it maintains a position inconsistent with that which it had adopted for tax year [REDACTED], i.e. the taxpayer seeks a double allowance of the NOL in tax years [REDACTED] and [REDACTED]. The double deduction is a circumstance covered by section 1312(2). The Service agrees with the taxpayer that its basis for the refund claim, section 172(f), is legally correct. If the Service allows the claim then the error, for purposes of the mitigation provisions, is the taxpayer's deduction of the section 172(f) amount in tax year [REDACTED]. See section 1312(2); Treas. Reg. §1.1311(a)-1(b). The "error" is not the Service's failure to assess the tax for tax year [REDACTED] prior to [REDACTED]. The fact that the Service failed to assess prior to [REDACTED] is irrelevant as to whether the mitigation provisions apply.

While the Service agrees that the taxpayer's claim for refund under section 172(f) is correct, it has not yet actually allowed the refund claim for tax year [REDACTED]. Therefore, there has not yet been a "determination" made under section 1313(a)(3)(A). If the Service allows the claim for refund for tax year [REDACTED] on the date the Service allows the claim a "determination" under the mitigation provisions will have been made. Section 1313(a)(3)(A); Vaughn v. Commissioner, TC Memo 1991-440. On that date, section 6501 will of course still bar the Service from

correcting the effect of the error in tax year [REDACTED]. The Service will therefore be allowed to make an adjustment that corrects the error in tax year [REDACTED]. The Service has one year from the date of the determination to assess the tax. Section 1314(b). The one year period begins to run on the date that the Service allows the claim for refund. Vaughn, TC Memo 1991-440.

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse affect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please note that this advisory memorandum is subject to post review by our National Office. If you have any questions please contact attorney Robert T. Bennett at (973) 645-3244.

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